UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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In the Matter of the Arbitration Between
GENERAL SECURITY NATIONAL INSURANCE COMPANY,

Petitioner,

-and-

AEQUICAP PROGRAM ADMINISTRATORS, INC.,

Respondent.
---X

10 Civ. 8682 (NRB)

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF
PETITION TO CONFIRM ARBITRATION AWARD

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Petitioner General Security National Insurance Company ("General Security") respectfully submits this Reply Memorandum of Law in further support of its Petition to confirm an arbitration award as a Judgment.

The sole argument raised by Respondent AequiCap Program Administrators, Inc. ("AequiCap") to oppose the Petition is that the Panel did not have authority to award of attorneys' fees.[1] AequiCap maintains that the award is inconsistent with a purported choice of law provision which required the Panel to apply New York state procedural law, and thus, is both in manifest disregard of the law and in excess of the Panel's authority. When AequiCap made the same argument to the Panel, both parties were requested to submit briefs. The Panel considered the law and proceeded to issue its award of attorneys' fees. A copy of the brief submitted by General Security ("GSB") is Exhibit 1 to the accompanying Reply Affidavit of Bruce M. Friedman. The GSB demonstrated that:

- there is no choice of law in the contract at issue and none was incorporated by reference (GSB 3-6)
- under well-established New York federal and state law, a general choice of law provision providing for New York law does not displace the Federal Arbitration Act or preclude a panel from awarding attorneys' fees (*Id.* 6-13)
- courts, including this Court and the Second Circuit, have rejected attempts to challenge arbitration awards of attorneys' fees despite New York choice of law clauses (*Id.* 13-15)

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[1] AequiCap only disputes the award of attorneys' fees, but refuses to pay the undisputed principal and interest granted by the award. It stated to the Court at a December 21, 2010 conference that it had not paid the undisputed portion of the award because there was a surety bond. A Performance Bond was issued by AequiCap Insurance Co., a related entity, which has also failed to honor its obligation. Accordingly, General Security filed a separate action to enforce that bond and other relief. *General Sec. Nat'l Ins. Co. v. AequiCap Ins. Co.*, 10 Civ. 9685 (NRB).

- AequiCap's own repeated demands for attorneys' fees render inapplicable any arguable limitation on the power of arbitrators to award attorneys' fees (*Id.* 20-22)

This Reply Memorandum shall not repeat these arguments, but shall be limited to a brief overview and refutation of specific points raised by AequiCap.

ARGUMENT

POINT I

THE ARBITRATORS APPLIED THE LAW BELIEVED TO BE APPLICABLE

1. There Was No "Manifest Disregard" Here

AequiCap argues that the arbitrators manifestly disregarded the law. This Court has recently recognized that "unlike courts, arbitrators do not have to give reasons for their decisions, and their decisions are essentially unappealable." *Goldman Sachs Executive & Clearing, L.P. v. Official Unsecured Creditors' Committee of Bayou Group, LLC*, 2010 WL 4877847 at *1 (S.D.N.Y.) A party disputing an arbitration award on the basis of "manifest disregard of the law" must demonstrate an "egregious impropriety" by the arbitrators. *T.Co Metals, LLC v. Dempsey Pipe & Supply, Inc.*, 592 F.3d 329, 339 (2d Cir. 2010). "[T]he award must be upheld unless the arbitration panel intentionally and erroneously disregarded a clear and plainly applicable law." *Goldman Sachs* at *2. If "a justifiable ground for the decision can be inferred," it should be confirmed. *T.Co*, at 339. AequiCap has failed to meet that standard.

2. The Panel Had The Authority To Award Attorneys' Fees

AequiCap also contends that the Panel exceeded its authority. However, in the context of this case, that contention derives from AequiCap's assertion that the arbitrators should have, but did not, apply New York State procedural law. Since the arbitrators issued their ruling only after considering the law alleged by each party to be applicable and obviously found in favor of applying the law advocated by General Security, each of AequiCap's assertions must fail in lockstep. Although an award may be vacated if the Panel exceeded its powers, that ground is accorded the "narrowest of readings." *T.Co,* 592 F.3d at 342. Contrary to AequiCap's assertion that the arbitrators "wantonly disregarded well-settled New York law" (at 2), the facts demonstrate otherwise. The Panel actually solicited briefs as to choice of law when confronted with the contention -- for the first time during a hearing set to fix the amount of the attorneys' fees to be awarded -- that they lacked authority to award them. At AequiCap's request, this Panel actually considered an issue that is usually referred to a reviewing court. Panels' determinations of the scope of their own authority are entitled to "considerable deference." *N.Y. State Fed. Physicians & Dentists v. Interfaith Med. Center*, 2007 WL 2743707 (E.D.N.Y.) *3; *accord Local 453, Int'l Union of Elec., Radio & Machine Workers v. Otis Elevator Co.*, 314 F.2d 25 (2d Cir. 1963). The arbitrators examined New York law and a substantive body of developed law under the FAA, and after careful deliberation and consideration, concluded that they had authority to award attorneys' fees. There is no reason to disturb that determination.

a) No Contractual Choice of Law Provision Applied to the Arbitration

The linchpin of AequiCap's position is the false assertion that there is an applicable choice of law provision. The contract at issue, the Amended Contingent Commission Agreement ("ACCA"), contains no such position. The ACCA incorporates by reference an arbitration provision from a separate contract, the "Underwriting Agreement;" but that arbitration provision is silent as to choice of law. The selection of New York as the location for the hearing is not a choice of law provision. The choice of law provision quoted by AequiCap (at 3, 8) is from elsewhere in the

Underwriting Agreement, but the ACCA did not incorporate that separate provision. AequiCap's repetition cannot alter this fact. In the absence of any choice of law provision in the ACCA, AequCap's entire position must fail and this Court need look no further.

3. New York Federal Courts Have Rejected Challenges to Arbitration Awards of Attorneys' Fees in Reinsurance Disputes

Two recent decisions involving reinsurance arbitrations are determinative. *ReliaStar Life Ins. Co. of N.Y. v. EMC Nat'l Life Ins. Co.*, 564 F.3d 81 (2d Cir. 2009) confirmed the award of attorneys' fees in a reinsurance arbitration, even though the applicable arbitration provision stated that each party would bear its own expenses. In addition to the unpaid reinsurance billings, the Panel also awarded $4 million in attorneys' fees and arbitration costs, explaining that it viewed the conduct of the reinsurer in the arbitration as "lacking good faith." The reinsurer moved to vacate the award of attorneys' fees on the ground that it conflicted with the arbitration provision.

The Second Circuit confirmed the full award. It explained that in reviewing arbitration awards, the court should confirm an award if it "draws its essence" from the agreement to arbitrate. (*Id.* at 85). Likewise, the scope of the arbitrator's authority depends upon the intent of the parties. Under a broad arbitration provision, like the one in the underlying arbitration, the Panel has "the discretion to order such remedies as they deem appropriate." (*Id.* at 86). That included the authority to sanction bad faith conduct, which may include attorneys' fees. (*Id.*). Awarding attorneys' fees which "fairly compensated the party for costs incurred as a result of" bad faith conduct is "compensatory, not penal, in nature and thus an appropriate form of damages." (*Id.* 86-87). Finally, the Second Circuit found that the allocation of attorneys' fees specified in the arbitration provision only applied when a party had acted in good faith. It explained:

> Indeed, the underlying purposes of arbitration, *i.e.*, efficient and swift resolution of disputes without protracted litigation, could not be achieved but for good faith arbitration by the parties. Consequently, sanctions, including attorneys' fees, are appropriately viewed as a remedy within an arbitrator's authority to effect the goals of arbitration. [Emphasis added]

(*Id.* at 87). Since the arbitration provision here is silent about allocating attorneys' fees and costs, there can be no question that this Panel has the authority to award attorneys' fees. By failing to conduct this arbitration in good faith, AequiCap exposed itself to sanctions, especially sanctions that compensate General Security for the damages caused by AequiCap's failure to arbitrate in good faith.[2]

In *Nat'l Union Fire Ins. Co. of Pittsburgh, PA. v. Odyssey America Reins. Corp.*, 2009 WL 4059183 at *3 (S.D.N.Y.) this Court confirmed an award of attorneys' fees in a reinsurance arbitration. Since the broad arbitration provision there at issue was silent about the allocation of attorneys' fees, the Court found that there was no question that the award "drew its essence" from the arbitration provision and was therefore within the Panel's authority. It also found that attorneys' fees awards issued in an arbitration proceeding were "properly characterized as compensatory damages." No express finding of "bad faith" was required.[3] Finally, the Court found that attorneys' fees are not precluded under New York State law. Citing *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995), it found that "the ability of an arbitrator to award attorneys' fees is . . . not a matter of substantive law which could be subject to a choice of law provision." (*Id.* at *7). The Panel could reasonably have relied upon these well-formed precedents.

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[2] AequiCap contends (at 9-10) that *ReliaStar* is distinguishable because that choice of law provision compels the use of the Federal Arbitration Act. In reality, the *ReliaStar* choice of law provision, *i.e.*, "the laws of the State of New York and to the extent applicable, the Federal Arbitration Act, shall govern the interpretation and application of this Agreement," does not impose the FAA where it would not otherwise apply. The phrase "to the extent applicable" recognizes the fact that the FAA can apply, but does not supersede otherwise applicable New York State law or expand the role of the FAA.

[3] Here, it may readily be inferred that the arbitrators' award of attorneys' fees resulted from the assessment that AequiCap never advocated a good faith basis to contest payment to General Security.

In this context, AequiCap cannot properly rely upon *Asturiana de Zinc Marketing Inc. v. LaSalle Rolling Mills, Inc.*, 20 F.Supp.2d 670 (S.D.N.Y. 1998). The portion of that case that questioned a panel's award of attorneys' fees was effectively overruled by the Second Circuit in *ReliaStar;* thus, it does not demonstrate that awarding attorneys' fees is "clearly" contrary to established law. The fact that this decision itself conceded that "the matter is hardly free from doubt" (*Id.* at 674) is alone proof that the law is not clearly contrary to the award. Finally, *Asturiana* characterizes the award of attorneys' fees as "substantive" rather than procedural law, which is contrary to well-established precedents, as demonstrated above. At most, even if it were still good law, *Asturiana* might show that the issue of the Panel's authority is open to question, but that cannot support "manifest disregard."[4] The law urged by AequiCap to be applicable is far from clear and plain.

4. The Panel is Not Required to Set Forth the Factual Basis for its Award of Attorneys' Fees

Implicit in the award of attorneys' fees is the Panel's finding: 1) that the ACCA does not contain a New York choice of law provision and/or that the Federal Arbitration Act governs, and 2) that AequiCap's conduct constituted bad faith. Neither finding is fundamentally irrational.

[4] We also note that, even before *ReliaStar,* this Court repeatedly distinguished *Asturiana. See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Savino*, 2007 WL 895767 (S.D.N.Y.); *Ludgate Ins. Co. Ltd. v. Banco de Seguros del Estado*, 2003 WL 443584 (S.D.N.Y.); *In re Northwestern Nat'l Ins. Co. and General Mexico Compania de Seguros,* 2000 WL 702996 (S.D.N.Y.).

AequiCap complains that its conduct did not constitute "bad faith" or was not sufficiently egregious to justify the award of attorneys' fees. The arbitrators here clearly disagreed. Moreover, whether a court would or could award them if confronted with the same facts is not a specified ground to vacate an arbitration award. *ReliaStar* confirmed an award where the Panel had viewed the conduct at issue as "lacking in good faith," finding that arbitration panels have the authority to award sanctions because "the underlying goals of arbitration, *i.e.* efficient and swift resolution of disputes without protracted litigation, could not be achieved without good faith arbitration by the parties." *Nat'l Union* confirmed an arbitration award of attorneys' fees that stated no factual finding. Even a "court's conviction that the arbitrator has committed serious error in resolving the disputed issue does not suffice to overturn his decision." *In re TIG Ins. Co. v. Global Int'l Reins. Co.*, 640 F.Supp.2d 519, 522 (S.D.N.Y. 2009).[5]

POINT II

GENERAL CHOICE OF LAW PROVISIONS DO NOT IMPOSE STATE LAW LIMITATION THE AUTHORITY OF ARBITRATORS

The "choice of law" provision quoted by AequiCap (at 3, 8) says nothing about the procedural law to be applied in arbitration. The GSB demonstrated that a general choice of law provision relating to substantive law does not impose the New York CPLR upon arbitrators, where, as here, there is a broad arbitration provision. *See Mastrobuono*, 514 U.S. 52, 59 (1995). The Supreme Court there concluded that the general choice of law provision related only to substantive law and should not be read to impose New York State's rules limiting the authority of arbitrators:

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[5] To illustrate the arguments and issues made to the Panel concerning AequiCap's misconduct, a copy of General Security's Pre-Hearing Brief (w/o exhibits) is attached as Exhibit 2 to the Friedman Reply Affidavit.

> We think the best way to harmonize the choice-of-law provision with the arbitration provision is to read "the laws of the State of New York" to encompass substantive principles that New York courts would apply, but not to include special rules limiting the authority of arbitrators. Thus, the choice-of-law provision covers the rights and duties of the parties, while the arbitration clause covers arbitration; neither sentence intrudes upon the other.

(*Id.* at 63-64). Similarly, this Court recently held in confirming a reinsurance arbitration award:

> the ability of an arbitrator to award attorneys' fees is similarly not a matter of substantive law which would be subject to the choice of law provision,
>
> * * *
>
> a New York choice of law provision does not preclude an arbitral award of attorneys' fees.

Nat'l Union, supra. AequiCap makes no effort to refute that legal analysis.

1. A New York Choice of Law Provision Does Not Displace the FAA

Contrary to AequiCap's assertions (at 10-12), the FAA, 9 U.S.C. § 1 *et seq.*, rather than the CPLR, is the law of New York State whenever an arbitration affects interstate commerce. That statute applies to all arbitrations that "affect interstate commerce." *See Diamond Waterproofing Systems Inc. v. 55 Liberty Owners Corp.*, 4 N.Y.3d 247 (2005). New York courts have routinely found that reinsurance disputes affect interstate commerce. *See e.g. In re Wurttembergische Feuerversicherung AG. v. Pan Atlantic Group, Inc.*, 130 A.D.2d 754 (App. Div. 1987)("Because the transactions between the parties involve interstate commerce, the Federal Arbitration Act applies."); *ReliaStar, supra*; *Nat'l Union, supra.*

New York state and federal courts both hold that general choice of law provisions in contracts providing for New York law do not require application of the CPLR rather than the FAA.

The Second Circuit rejected a challenge to an award of attorneys' fees which argued that a New York choice of law provision superseded the FAA in *PaineWebber Inc. v. Bybyk*, 81 F.3d 1193, 1202 (2d Cir. 1996):

> [A] choice of law provision will not be construed to impose substantive restrictions on the parties' rights under the Federal Arbitration Act, including the right to arbitrate claims for attorneys' fees. Therefore, Paine Webber cannot rely on the New York choice-of-law provision to prevent the *Bybyks* from seeking in arbitration a remedy that is not foreclosed by the Agreement. [Citation omitted]

Accord Smith v. Positive Productions, 419 F.Supp.2d 437, 454 (S.D.N.Y. 2005) ("even if there is a choice of law clause selecting New York law, the parties may arbitrate the issue of attorneys' fees."); *In re Cone Mills Corp. v. August F. Nielsen Co., Inc.*, 90 A.D.2d 31, 32-33 (App. Div. 1982) ("The contractual stipulation that New York law governs the arbitration does not displace the Federal Arbitration Act."). These repeated, clear precedents leave no room for doubt.

2. The Arbitration Provision Grants the Authority to Award Attorneys' Fees

AequiCap does not dispute the contractual breadth of the Panel's authority, but only that the CPLR restricts it. The applicable arbitration provision grants the Panel broad authority to determine disputes between the parties. The broad language ("any disagreement or dispute . . . as to the effect or interpretation of any terms, provisions or conditions of this Agreement, or as to the performance of either party") logically includes a dispute about whether attorneys' fees can be awarded. AequiCap does not dispute this position.

3. AequiCap Authorized the Panel to Determine Whether to Award Attorneys' Fees

AequiCap concedes (at 15) that an arbitration panel has the authority to award attorneys' fees if both parties request that it do so or acquiesce. *Merrill Lynch, supra,* 2007 WL 895767 at *18;

Bear Stearns & Co., Inc. v. Fulco, 21 Misc.3d 823, 830 (Sup. Ct. N.Y. Co. 2008) ("when the record shows that the parties have acquiesced in the awarding of attorneys' fees by their conduct during the arbitration, including by demanding attorneys' fees in their submissions.")

AequiCap demanded attorneys' fees in writing at least three times during the arbitration: in a Supplemental Position Statement, in a Pre-Hearing Brief and in a Reply Pre-Hearing Brief. (GSB at 17-18). AequiCap seeks to overcome the consequences of its own conduct by referring to a limited exception: if the request was mere "boilerplate" in a preliminary pleading, "and the party does not pursue the request during arbitration," then the Panel's authority may be disputed. (at 15-16). By reiterating its request for attorneys' fees three times, however, AequiCap's requests were not mere boilerplate, but knowing and purposeful acts. AequiCap is bound by its own conduct and cannot be permitted to escape the consequences. Indeed, AequiCap did not challenge the Panel's authority until after it denied AequiCap's request for the same relief.

CONCLUSION

AequiCap's latest effort to avoid the arbitration award, delay paying its obligations and impose unnecessary costs upon General Security is utterly frivolous. There is no legal basis to permit AequiCap to avoid responsibility for its misconduct. The applicable facts and legal analysis presented to the Panel dispel any notion that the Panel's award was in "manifest disregard." There is far more than a "colorable basis" for the award here. AequiCap's tactics further demonstrate the wisdom of the Panel's determination to award attorneys' fees. Accordingly, this Court should confirm the award and award General Security its costs and reasonable attorneys' fees incurred in this proceeding.

Dated: New York, New York
February 2, 2011

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